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Special Edition

Re-design of financial supervisory architecture

- Transcript of the interview of Professor Franklin Allen by Tetsuya Inoue -

Nomura Research Institute, Ltd.

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In the ongoing debate on financial supervision in the US and Europe, attention has focused on reviewing the role of supervisory bodies. But we must not neglect more fundamental issues such as the global lessons of the financial crisis, assessment of the public sector's response to the crisis, and the ideal relationship between monetary policy and financial supervision. We spoke with Prof. Franklin Allen of the University of Pennsylvania's Wharton School.

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Background of current financial crisis

Inoue

It is my honor to speak with you today about the financial markets.

I would like to discuss the future of financial supervision, based on our experiences in the current financial crisis. Financial supervision has been the focus of a great deal of attention in the US and Europe. The implications for Japan are also significant. Financial supervisors are introducing a kind of internationally harmonized framework for systemically important financial institutions, which includes some of the major Japanese players. And global supervisors would likely demand a level playing field for global players.

First, let us first briefly review the financial crisis since August 2007.

Prof. Allen

I think the crisis has two main causes.

The first is that the Federal Reserve, and to some extent other central banks, kept interest rates too low for too long. That set off the bubble in US financial markets which is at the heart of what has gone wrong. There was a huge run-up in housing prices, and the bursting of this bubble caused subprime borrowers to start defaulting, which in turn led to a meltdown in securitizations. Here I think there are a lot of issues concerning central bank governance that currently are not on the agenda but will become clearer in time.

Central bank independence is good for fighting inflation, but bad for financial stability, because it allows central banks to take tremendous risks with no checks and balances. In reality, it was essentially the former Fed chairman who decided to hold interest rates at 1%.

Inoue

You mean there was no collective decision?

Prof. Allen

Although things are different now, that is how the former chairman ran the Board. When quantitative easing—which I would say is a very risky policy—was introduced, the Fed thought it could be reversed in the event of inflation. But I think this is being much too optimistic: if there were a run on the dollar, the Fed might find it difficult to sell bonds to the markets. Very few in Congress would fully understand what quantitative easing means. I think that would be an example of the kind of risk the public sector is taking.

I think there will be reform of central bank governance at some stage. However, the problem with Congressional oversight is that politicians do not really know the right questions to ask. I do not think they would have asked the former chairman whether it was a good idea to have 1% interest rates when house prices were rising at a significantly faster rate. Nick Stern wrote an interesting op-ed piece in the *Financial Times* suggesting that an independent international body be endowed to serve as a central bank either domestically or internationally. Or, as in the case of the TARP, we could have an oversight committee like the one headed by Elizabeth Warren.

Inoue

I attended a number of international meetings of the central banking community during the years of the "great moderation," and I have the same impression about the impact of overly accommodative global monetary policy on the creation of financial bubbles.

Looking further back, central bankers have been searching for a kind of nominal anchor for the conduct of monetary policy ever since the collapse of the Bretton Woods system. They have clung to the idea of a money supply regime or inflation targeting and have been largely successful in stabilizing the prices of physical goods and services.

Prof. Allen

But it has been a complete disaster in terms of financial stability.

The second cause of the current crisis is global imbalances. It was not just the US that experienced a property bubble, but also Spain, Ireland, and the UK. And in these countries, interest rate policies are not so much to blame. The cause probably lies elsewhere. I would call attention to global imbalances and in particular the massive accumulation of funds by Asian central banks. This, in turn, can be traced to the behavior of the IMF in the Asian crisis. Countries like Korea, which had a good economic record and were experiencing temporary problems because companies had borrowed too much in foreign currencies, needed short-term help. But the IMF forced them to raise interest rates and cut government expenditures—exactly the opposite of what Europe and the US have done when faced with similar circumstances. In addition, the Koreans were unable to reject the IMF's proposals. I think that after this, Asian countries decided not to go to the IMF out of concern they would not be treated fairly. Instead, they accumulated huge reserves, which played a big role in the current crisis. Much of the reserves was invested in debt securities and ended up making it much easier for homebuyers in many countries to obtain mortgages.

Inoue

Before the current crisis, central banks in emerging economies played a significant role in importing monetary easing from the advanced economies. The challenge for them is how to coordinate FX policy with monetary policy. Even Japan feared the appreciation of its currency because of the potential harm to exports. Such sentiment is still prevalent in most Asian economies. This is why they managed their FX rates with little flexibility, which effectively resulted in the import of easy monetary policy by areas with much higher potential growth rates. That led to bubbles in emerging markets as well, and they were hit hard by the collapse of the advanced markets. These global correlations of financial asset prices cannot be explained by the traditional mechanism of transmission of shocks.

Prof. Allen

I agree. There are several issues in terms of Chinese policy. First, I wonder if China is going to stop its savings from flowing to the US. Second, what is China is going to do with its foreign exchange reserves, which now amount to about 50% of GDP? They may begin to realize that they are never going to get their money back. They will be lucky if they get 60 cents out of a dollar, in purchasing power terms. It could result in their donating 20% or 30% of GDP to US consumers.

Inoue

I think the Chinese authorities are already well aware of this situation and at the same time fully understand that there is no short-term remedy. Thus the Chinese economy is becoming increasingly integrated with the US economy, in terms of both trade and financial markets.

Prof. Allen

That is the truth. It is interesting to remember that there are many stories about what China was doing when the dollar was very weak about six months ago. The Chinese were not selling US Treasurys, but were swapping out US dollars into the euro. One wonders how much they were doing, because their public comments suggest that there were no alternatives to the US dollar. In fact, they were significantly underweighted in the euro for some proportion of the portfolio. Because the US dollar is so weak against so many currencies at the moment, I would not be surprised if the Chinese are swapping into the euro, yen, and pound. In particular, I do not understand why the pound is so strong at the moment relative to the US dollar. It should not be happening, because the UK is doing worse than the US in terms of fiscal problems. My guess is that the Chinese might be swapping into the pound. But it may be hidden anyway, because market volumes are so large.

Inoue

I do not think that the Chinese government seeks short-term returns from its FX reserves. Instead, I think it is trying to manage the reserves from a longer-term perspective. In this regard, it cannot change the amount of its reserves to a meaningful degree and probably seeks a more diversified portfolio.

Prof. Allen

Which do you think is probable: do they want to get the imbalances down to zero or do they want to accumulate foreign exchange reserves worth 100% of GDP?

Inoue

Given the huge amount of reserves they currently hold, they might want to use them for more political purposes.

Prof. Allen

That is true. It gives them huge political advantages.

Inoue

From a different perspective, China plays an important role as a stakeholder in US financial markets and effectively provides governance over US fiscal policy and the US financial markets, although you may not agree. For example, you may recall the case of the GSE problems last September.

Prof. Allen

No, I agree. They played a huge role in prompting the US Treasury to undertake meaningful measures.

Inoue

I do not think that Japan could have played this kind of role in the past, because it was a silent, passive investor. In that sense, sound governance by China could have a more positive impact in the long run for both China and the United States.

Prof. Allen

You are right, and this is an interesting point. The perception that I would agree with is that the Chinese economy is getting bigger and bigger, and they will have a tremendously effective influence in the short and the medium run.

Inoue

As an example of China's long-term perspective, the Chinese government has recently been pressing to expand its currency swap network. This is a very interesting development. While the Yuan is not convertible at the moment, China is introducing swaps with Latin American countries as well as Asian countries. I think they are paving the way for making the Yuan an international currency in the very long run.

Prof. Allen

I rather think it reflects the fact that the Chinese Yuan is the strongest currency in the world. Investors would *like* to put their money in the Yuan.

In any event, the second cause of the current crisis will require many changes to the IMF. I do not think they understand the scale of the problem, though they are currently talking about it. For example, there has been no Japanese head of the IMF, even though Japan has been the second largest economy for many decades now. With China on the rise, too, the IMF needs a whole reorientation towards Asia. Key reforms needed for the IMF include governance, quotas, and more power for Asians and less for Europeans.

I think those are the two big issues that could have prevented what has happened. But they are not on the agenda, and no one wants to talk about reforming the central banks. Moreover, there have been only marginal suggestions regarding reforms to the IMF.

Prevention of systemic risks

Prof. Allen

The other big thing that should happen is reform of the mechanisms for resolving systemically important cross-border institutions. The case of Lehman Brothers made it clear that we do not have a good mechanism for resolving such institutions, and that is a huge problem. It is also true in the EU. While they have some hope of solving such problems, there are many big cross-border institutions, and it is not at all clear what will happen if one of them fails.

We probably need to talk about things like revising the Basel Agreement. But the Basel Agreement did nothing to prevent any of the financial crises. The magnitude of the adjustments in asset prices has been large enough to swamp any reasonable amount of capital that the regulations might mandate. Even a 10% capital requirement is not going to stop the troubles resulting from a 30% fall in property prices.

Inoue

I remember a comment by a senior person at Goldman Sachs in the early months of the financial turmoil in 2007. He noted that that there had been 7.5-sigma movements on several consecutive days.

Prof. Allen

This is not the kind of thing that the public sector should spend a lot of time on at the moment. The first thing is to stop what is happening now. Then they need to decide what to do next time.

I do not think the private sector thought they were taking really big risks. The problem was that we had subprime mortgages on which problems were triggered so quickly. Also, no one seemed to think that prices in the property sector could go down in the US, because the data showed a rising trend for the last 70 years. On the other hand, you could go to the newsstand and pick up a copy of *The Economist* and it would tell you there was a bubble in US real estate prices. In spite of all these very simple indicators, none of the sophisticated people on Wall Street who were evaluating these securities bothered to use Asian data or to look at what had happened in Asia or even in Europe. I am not sure how you regulate this kind of phenomenon.

I do not think the public sector will address what should be done next time, or when and how they should step in. Rather, they will say "we are going to change the regulatory system to prevent a crisis from happening again." But I am afraid that a crisis *will* happen again. My own view is that what they have done so far is probably the worst of all; they have handed over trillions of dollars with virtually no accountability. This could set a very bad precedent.

If we are going to have private systems of finance, it is fine to have "too big to fail" policies. I think contagion is a problem that we do not fully understand. Lehman Brothers illustrates how complex it can be. The traditional view of contagion is of a domino effect, the kind of thing that Bernanke outlined in his Jackson Hole speech last August. But it is more complicated than that. With Lehman Brothers' bankruptcy, part of the transmission was the traditional domino effect through the money market, but there were also many more subtle things going on. It is very difficult to deal with that, and you have to decide what you are going to do if you let these large institutions go bankrupt.

I think we have to move towards a policy where any institution that fails is to be wound up. The problem at the moment is that if institutions taking big risks know they are going to be saved, then they will continue to do so. That is going to be a huge problem. Even worse, the institutions that are prudent and that make the right decisions do not benefit. So you have doubly bad incentives. What we need to do now is get rid of the top five people straight away from the ailing big banks. Then the banks need to be systematically liquidated and their assets sold off. The banks that have done well should be allowed to expand and be rewarded for being prudent. At the moment, the banks that have been rewarded are effectively the ones that made the worst decisions. We need to change this system drastically. The auto industry is another example. If the big companies had been allowed to go bankrupt, one very good company would have survived, and it would have been able to compete with global rivals. And we must not nationalize the banks permanently; we should temporarily nationalize them and then liquidate them. The ones allowed to survive and expand will be smaller and better- shaped. We have some idea of the creative destruction that recessions often offer.

Inoue

When I visited the US in March, a professor reminded me that the prevailing "fashion" when the ECB was established was that the central bank should concentrate exclusively on monetary policy. You may also remember that the BOJ was criticized for doing "dirty" things halfway between monetary policy and financial stability policy. The central banking community has been characterized by a very strong dichotomy.

Prof. Allen

That is why they split off the FSA in the UK—I think they had no clear idea what systemic risk was. And I actually think the BOJ did very well. We will see how well the Americans do, but so far it tracks the downside.

Inoue

The ECB was said to have a great deal of trouble collecting accurate information on the respective major players in the financial system after the current crisis broke.

Prof. Allen

It is a very poor system in terms of the ECB knowing what is going on. For example, when the rogue trader appeared at a major French bank, the ECB did not seem to know, it would presumably have told the Fed. It was not a disaster, but at some point in the future this could be a real problem.

Inoue

This kind of lesson would have many implications for the issue of the central bank's role in the new financial supervisory architecture.

Prof. Allen

I think that is going to be the key issue, because no central bank has got the right relationship between monetary policy and financial stability. The Fed got it wrong, because they really did not attend to financial stability. The Bank of England (BOE) in some ways has a good record, but they kept firing financial experts. They fired people who were experts on financial stability in the 1990's and then had a big hiring of financial stability people after the Asian crisis. A similar thing happened with the current crisis.

Inoue

The accountability of central banks for financial stability would be a related issue. Actually I remember that some BOJ watchers sometimes criticized the lack of accountability during the previous financial crisis, because some important decisions were made by the board of executives rather than by the policy board. For example, you may remember the BOJ's purchase of equities from the banking sector.

Prof. Allen

It becomes an issue when monetary policy is not effective.

Inoue

You would like to revise the structures for decision making within central banks.

Prof. Allen

We should revise them. But the problem is that we do not yet know how to do it. The BOE wants to have both a financial stability committee and a monetary policy committee, because intellectually they represent separate ways of thinking about things. But I think that, ultimately, there has to be one decision-making process that decides everything, because it is all one financial system and ultimately it all plays into the financial system. While we are a long way from even thinking about how to do that, I do not think we are going to go back to a program of inflation targeting where all the central bank considers and all it looks at is the real economy.

Inoue

How about governance from outside the central bank?

Prof. Allen

I think this is the big problem. I am not sure whether we should go back to the Treasury, but we need a new system. Nevertheless, I do not think this is going to happen quickly. Most central bankers probably still think they are doing a fine job and do not have these kinds of issues on their agenda. There are 42 central banks that issue financial stability reports, and the Fed is not one of them. The Fed has not gone through a systematic process of thinking about financial stability on a regular basis.

Inoue

It is interesting. Looking at regulatory proposals, it seems the trend is to encourage the establishment of a kind of board consisting of both the central bank and government bodies to address systemic risks.

Prof. Allen

They have to make it clear what they think systemic risk is. They may think it involves risk-taking by banks, but I am not sure that is actually the case. It probably does not help that the players had such high leverage ratios. But if you think of systemic risk as bubbles plus global imbalances, it would not be a matter solely of the private sector but would be closely related to the public sector. Actually, many people in the mortgage industry took many risks, and now we have to stop that, but I do not think that is at the heart of what systemic risk is about.

Inoue

I see. Regarding the prevention of systemic risks, you would like to place priority on correcting financial transactions rather than just monitoring them intensively.

Prof. Allen

We have to think very hard about how to do that. Limiting the level of leverage is a good idea, but there you get into the issue of selecting the institutions to regulate. Drawing the boundary is going to be very difficult. If you have a manufacturing company that happens to have large financial operations, what do you do?

Inoue

There may be deep regret within the public sector that they were unable to engage in any meaningful action and lacked ways to monitor the financial markets. I think that central banks in the advanced economies were well aware of the concentration of risk and the potential risk to the global financial system.

Prof. Allen

What do they think the cause is? What do they think systemic risk is? They view systemic risk as simply being high leverage. Even without high leverage, a 30% fall in property prices is going to cause a big problem.

My own view is that this is different from the Japanese bubble. In the 1990s, the BOJ and Japan's policy makers did a pretty good job given what they faced. But I do not think there was a huge amount of leverage in the Japan. Even without significant leverage, we observed enormous problems. So I am not so sure how much people should focus on leverage as a cause of the problem. Spain is having many problems at the moment. The Bank of Spain did a wonderful job, and the major private banks are doing fine, but the real economy is in a complete mess. We have to think very carefully about where the problems lie. The financial system having problems is an issue, but it is not so clear to what extent the bad real economy is a result of this.

Inoue

I am fully aware of these examples. But I think that central bankers and financial authorities tend to believe that having the latest, most accurate financial market information could make a real difference.

Prof. Allen

How would they have applied it?

Inoue

This is the problem. Even if central banks could obtain timelier and more accurate information about financial markets, it might not translate to meaningful policy actions.

Prof. Allen

It seems to me what they would have needed to do was to figure out that there was a property bubble, which the private markets in the US somehow missed. But I do not think they thought there was a property bubble—after all, they were the people who caused it. So I am not sure how much of this would be helpful. What we have to do is to come up with a set of systems that would have resolved the problem.

Inoue

I agree. Even if the central bank or financial authority were able to collect all financial market information, they could not process it, and the end result would be that the information piled up untouched.

Prof. Allen

Right. I am sure that there were particular instances where better information could have led to better decisions. But while the New York Fed must have had complete information about Lehman Brothers, we know they made the wrong decision. Proprietary information is also a real issue.

Inoue

And even if the central bank believes it could collect all necessary information, huge amounts of human resources are needed.

Prof. Allen

I do not think they are going to get that, but in any case I do not think it would do them much good.

Unconventional monetary policy

Inoue

With regard to the discussion about unconventional monetary policy, almost everyone I met in New York as well as in Washington DC in March expressed strong opposition to the government bonds purchase operations. It was in a sense a novel experience for me, because JGB market participants would take this kind of operation by the central bank as a given. In addition, Japanese people tend to believe less in the effectiveness of quantitative easing. Specifically, a number of academic researchers claimed that our original quantitative easing was not so successful in stimulating the economy and inflation expectations. In the eyes of the Japanese, therefore, there is little risk of side-effects from the government bond purchases, including the sparking of inflation expectations.

Prof. Allen

I do not think Japan's quantitative easing had much effect except possibly for the "yen carry trade," which caused huge currency outflows and which I think was part of the reason that Australia and New Zealand have had such big property bubbles. But I don't know for sure whether it is going to be the same in the US. One of the things that I find very interesting at the moment is the way the stock market is booming in the US even though all the real information is bad. The reason is said to be that all the real indicators look ready to bottom out. But I think it has something to do with the huge amounts of money that have been pumped into the system. It is also interesting that bond yields are shooting up. This is what happens in the financial markets when you have these unconventional monetary policy interventions. I do not think we understand them very much at all, and they could be potentially very damaging. So I do not think we can separate monetary policy and financial stability.

Inoue

It is interesting to note, however, that at the meetings of our Financial Markets Panel, members argued that we should be very careful about applying Japan's experience with quantitative easing to the current crisis. The most important fundamental difference in the economy is the risk of inflation. During Japan's previous crisis, the expansion of production in emerging economies such as China added to a domestic imbalance of aggregate demand and supply as a major source of deflationary pressure. In other words, a significant part of the deflation was from imported products.

Prof. Allen

That is very interesting. Is it documented?

Inoue

There is evidence in the regular charts of the BOJ's monthly economic reports that analyze the sources of deflation. Moreover, with the Japanese so accustomed to very low inflation, it would be psychologically difficult to generate inflation expectations. Considering these specific features of the Japanese economy, we should be careful about applying the results of quantitative easing in Japan to the current crisis.

In addition, the global scale of operations this time—not only by the Fed but also by the ECB, the BOE and the BOJ—is far larger, although Japan's quantitative easing was huge in relation to the size of the domestic market. This could affect the composition of global financial assets, which could have a non-negligible impact on the entire spectrum of financial asset prices. So we need to monitor developments closely in this area.

Revision of financial supervision

Inoue

As the Lehman Brothers crisis made clear, financial supervision remains localized despite growth in the cross-border activities of major financial institutions. Do you think is there any way to overcome this kind of problem? For example, the Senior Supervisors Group seems to be introducing some kind of coordination of supervision across the major markets.

Prof. Allen

There are two ways to go: we can either have more globalization of the financial system or we can have less. If you had a whole global system for coordination and agreements on burden sharing, that would work fine. But I do not think we are going to get that. In that case, we will probably go back towards more national-based systems.

Inoue

So you are pessimistic about enhancing global coordination.

Prof. Allen

Yes, I am.

Inoue

But as you pointed out, with the consolidation of the financial industry and financial innovation, there may be a natural tendency towards bigger and more complicated financial institutions and further integration of global financial markets.

Prof. Allen

Right. The question is when governments pick up the bill whether they are going to be willing to allow this. I think the UK has a very interesting decision to make. Is it going to allow big banks in the UK? We will see what happens with that. Large banks in the UK caused a large part of their fiscal problems.

Inoue

Could we not expect some integration of financial supervision across major markets such as London, New York, Tokyo and Singapore?

Prof. Allen

You might see some of it, but there may always be the problem of who should pay if something goes wrong. I think that is going to be much more difficult. Since even the EU cannot seem to come to a decision on that, how could we make that decision globally?

Inoue

You are absolutely right about the EU, in spite of the earlier enthusiasm. For example, the European Systemic Risk Council proposed by the de Larosière report would serve as a coordinator between the ECB and supervisors.

Prof. Allen

Members would pursue their national interests again. Going back to the case of the major French bank, the Bank of France was apparently looking after its own interests.

Inoue

So it is of the utmost importance not to create a financial environment that stimulates excessive risk-taking, and instead to make significant efforts towards re-designing financial regulations.

Prof. Allen

Yes.

Inoue

In relation to this, what kind of role do you think the central bank should play in the context of financial supervision or financial regulations?

Prof. Allen

I am a strong supporter of having everything in the central bank. I do not think the FSA works very well, because in a crisis no one has the information that they need. They just do not know what is going on. And it would not be the same if somebody at the BOE asks somebody at the FSA. But if somebody at the BOE calls somebody else at the BOE, it would be very, very different.

Inoue

While I agree that the central bank is already in a good position to monitor the financial markets closely and in a timely fashion, I am skeptical about the idea that the central bank should become involved in the process of resolving failing banks or enforcing regulations.

Prof. Allen

So, you would rather have an FSA to do that? It was done that way for many years, so the FSA is a relatively modern concept. Didn't it work fine for all those years?

Inoue

You need some other body within the government so that there is a division of labor between the central bank and the regulatory bodies. The reason for my argument is that too much involvement of the central bank in the fate of individual financial institution could threaten the independence of monetary policy. The central bank would become too involved in the political process.

Prof. Allen

Well, it is true that there are huge fiscal consequences. But, if you are going to combine monetary policy and financial stability policy, I think it is very difficult to avoid that. If, for example, the Fed is going to have a $4 trillion balance sheet, they will have 20% or more of GDP on their balance sheet. I think that is the real issue. Something has gone wrong in the government process if the central bank is doing these things under the current framework.

Inoue

I agree. As you pointed out, the concept of monetary policy independence is closely related to the idea that the stabilization of inflation is the sole purpose of a central bank. I think that we need to discuss these kinds of fundamental issues. The role of central banks would be at the core of the discussion.

Prof. Allen

That is my idea. But, I think there is a real question of whether the supervision makes much sense. Supervision is a sensible idea if the real problem is that there is a rogue bank that is going to take a lot of risk. But there is not much evidence that that is the case, and I am not sure what these supervisors actually achieved and whether they stopped any of the problems. I am not sure, either, that things would be much different if you just took them all away. What do you think the central banks think that these supervisors are doing?

Inoue

Their core role is to enforce regulations. For example, regulation could limit the maximum amount of leverage. Within this band, I think closer dialogue between market players and the public sector would pave the way to stabilizing the amount of leverage.

Prof. Allen

Were they stopping the banks from taking excessive risks? I don't think that supervisors could effectively stop the problems. Even in the case of commercial banks, what good does it do us to have supervisors looking at and checking the banks' loans? What do you think that is supposed to achieve? Going forward, I understand that we may want to have leverage constraints, for example, because there is a lot of risk. But what supervisors do now is to go and look at the loans and supervise them according to the regulations. I am not sure this really achieves much in terms of systemic risk.

Inoue

I agree. To reduce the risk of systemic events, detailed and timely market information would be needed. Under the current framework of financial supervision, reports can be collected no more often than on a monthly basis, which is not useful for identifying concentration risk. Surely the central bank is in a good position to do this, because in a sense they are already collecting such information in money markets, government bond markets, and FX markets. Nevertheless, I think the market might also need a kind of policeman. Sometimes financial institutions need to understand that they could be arrested for bad behavior.

Prof. Allen

I think this role should be played by bankruptcy. If you do things that are wrong, you go bankrupt and you lose everything. What is wrong with the financial system is that we do not yet have such a mechanism. Putting that kind of mechanism into place is a better way of policing than having somebody looking over somebody's shoulder. And I do not think that we are very good at stopping somewhere between the regulated world and the not–regulated world. Orderly bankruptcy should be the focus of regulation.

Lastly, I would like to touch on the issue of mark-to-market accounting, which is very important for the financial stability debate. This is at the heart of all the problems with toxic assets. I think the pricing function of many markets has broken down and we need new regulations. We have to think hard about what should be done when assets seem mispriced. While it may appear to be an accounting debate, I think it is really more of a systemic issue.

Inoue

I have two points to make about the mark-to-market treatment of financial assets. First, Japanese banks were heavily criticized for being slow to introduce mark-to-market accounting in the previous crisis. Second, from a fundamental point of view, gradualism could be a good strategy if there were a low-growth environment in the global economy after the collapse of a financial bubble.

Prof. Allen

I agree with that.

Inoue

If you cling to the idea of mark-to-market accounting, toxic assets could be wiped out in a very short period of time. This kind of strategy would be reasonable if you expect a V-shaped economic recovery. However, if the recovery is more likely to be U- or L-shaped, the gradual realization of financial losses could be a useful strategy.

Thank you very much for your insights.

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